In the Supreme Court of the United States

OCTOBER TERM, 1924

UNITED STATES OF AMERICA, PETITIONER
v.
EDWARD H. CHILDS, TRUSTEE in BANKRUPTCY of J. Menist Company (Inc.) } No. 80

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF ON BEHALF OF THE UNITED STATES

By this writ of certiorari the United States seeks to review a judgment of the Circuit Court of Appeals for the Second Circuit affirming an order in bankruptcy of the District Court for the Southern District of New York disallowing interest at the rate of 1 per cent per month on a claim of the United States for taxes and allowing interest at the rate of only 6 per cent per year.

STATEMENT

On September 30, 1919, the United States assessed against the corporate income of J. Menist Company, Incorporated, an additional tax of $2,421.75 for the taxable year 1917, and demanded that the same be paid on or before December 11, 1919. No payment

was made and the corporation was adjudged bankrupt on April 6, 1920.

On May 5, 1921, the United States, through the Collector of Internal Revenue for the Second Collection District of New York, filed a claim in the Bankruptcy court for the said tax plus 5 per cent penalty and 1 per cent per month interest until paid. Under the provisions of Section 57–j of the Bankruptcy Act, the United States withdrew its claim for the penalty of 5 per cent, but insisted that interest at the rate of 1 per cent per month from ten days after due notice and demand for the payment of the tax should be allowed.

The District Court held that interest at the rate of 1 per cent per month was a penalty, and therefore declined to allow interest at that rate, but did allow interest at the rate of 6 per cent per year. That judgment was affirmed by the Circuit Court of Appeals, and its judgment now comes before this Court for review.

QUESTION INVOLVED

Is interest at the rate of 1 per cent per month, as provided by the Federal Internal Revenue laws, collectible after due notice and demand from the estate of a bankrupt?

STATUTES INVOLVED

Section 212 of the Act of October 3, 1917 (40 Stat., chap. 63, p. 300), makes Section 14(a) of the Act of September 8, 1916 (39 Stat., chap. 463, p. 756),

applicable to taxes under the Act of 1917. Section 14 (a) provides that:

> * * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid *and interest at the rate of one per centum per month upon said tax from the time the same becomes due.*

Section 57–j of the Bankruptcy Act (30 Stat., chap. 541, p. 544) provides:

> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby *and such interest as may have accrued thereon according to law.* [Italics ours.]

ARGUMENT

I

The Government is entitled to interest upon its claim at the rate of 1 per centum per month

The error in the instant case lies in the Court having almost entirely confined its consideration to the provisions of Section 57-j of the Bankruptcy Act, practically ignoring the equally important and

pertinent provisions of Section 14(a) of the Revenue Act. Inasmuch as the question involved is as much one of taxation as of bankruptcy, these two sections must be construed consistently with each other and so that the one will explain and support and not defeat or destroy the other.

While Section 57-j of the Bankruptcy Act forbids the allowance of penalties against the estate of a bankrupt it specifically allows "*such interest as may have accrued * * * according to law.*" The law allowing interest in such cases as this is Section 14(a) of the Revenue Act, which provides that there shall be paid on delinquent taxes "*interest at the rate of 1 per centum per month upon said tax from the time same becomes due.*"

It is also to be noted that in thus providing for interest Section 14(a) is so framed as to recognize the distinction which Section 57–j makes between penalties and interest. It provides that "to any sum or sums due and unpaid * * * there shall be added the sum of five per centum on the amount of tax unpaid and *interest at the rate,*" etc.

The word "interest" is clearly used here in contradistinction to the 5 per centum which manifestly belongs to the category of penalties. The Treasury Department has consistently so held.

It is well established that a uniform construction of a law by the executive officers charged with its administration has great weight, if not controlling force, and the courts in construing it will accept that construction as the proper one unless it is manifestly

contrary to the letter or spirit of the law. *Pennoyer* v. *McConnaughty*, 140 U. S. 1.

The distinction between "penalty" and "interest" is also recognized by the revenue laws of other years. Section 3184 of the Revised Statutes specifically denominates the "5 per centum additional" as a "*penalty*" and imposes in addition thereto "*interest* at the rate of 1 per centum per month." Section 903 of the Revenue Act of 1918 (40 Stat. chap. 18, p. 1057) differs only slightly and provides that "there shall be added as a part of the tax a *penalty* of 5 per centum, together with *interest* at the rate of 1 per centum for each full month."

Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention. *Brown* v. *Hiatts*, 15 Wall. 177. *Interest* is distinguished from *penalty*, which is a sum of money the law exacts payment of by way of *punishment*. *Sparks* v. *Lowndes County*, 98 Ga. 284; *New Whatcom* v. *Roeder*, 22 Wash. 570. Penalty is synonymous with punishment. *United States* v. *Reisinger*, 128 U. S. 398.

Notwithstanding this fundamental distinction and despite the fact that the statute provides for interest *eo nomine*, in contradistinction to a penalty, the court in the case at bar disallowed such interest on the ground that it was a penalty.

By Section 14 (a) Congress clearly intended to do two distinct things: First, to penalize the failure to pay the tax when due, and, second, to recompense

the Government not only for the forbearance of the amount of the tax during the period of delinquency but also for the actual damages sustained by the Government by reason of the expense incident to the collection of such delinquent tax. The provision for a specific penalty of 5 per centum, followed immediately by the provision for "interest at 1 per centum per month" precludes any other construction than that Congress intended to and did use the word "interest" in the sense in which that word is commonly used and understood, and intended that the 1 per centum per month should be paid solely as interest. Calculation of the latter at a rate per cent per month further evidences the intention of Congress to charge such rate as interest.

Revenue laws are to be so construed as to carry out the intention of the legislature in passing them. *United States* v. *Stowell*, 133 U. S. 1. The intention must be found from the language used. *Merritt* v. *Welsh*, 104 U. S. 694. The word "interest" is to be understood in its ordinary sense. *United States* v. *Isham*, 17 Wall 496. To hold that Congress intended to use the word in the sense of a penalty is contrary to all rules of interpretation and invokes a special definition of the word "interest" that is unwarranted.

In the case of *United States* v. *Guest* (C. C. A. 4th Cir.), 143 Fed. 456, the question presented was whether the rate of 1 per centum per month as claimed under Section 3184 R. S. was in the nature

of a penalty, and therefore barred by the statute of limitations (Section 1047 R. S.), or whether it was intended as interest *eo nomine*, and therefore collectible as a part of the tax. The Court held that "*this is recoverable as interest, and is not a penalty; there being a 5 per cent penalty specifically prescribed on the amount of the tax.*" This case is directly in point with the case at bar.

Moreover, in *Chattanooga* v. *Hill*, 139 Fed. 600, the Court says:

> The bankrupt might have paid all taxes immediately prior to the filing of a petition by or against him. This would not have been a preference. *The law means that the trustee shall do what the bankrupt might have done* and what good citizenship requires him to do.

The taxpayer (bankrupt), of course, would have been required to pay interest at 1 per centum per month in the case at bar if bankruptcy had not intervened. This principle was applied directly to the question of interest in the case of *In re Kallak*, 147 Fed. 276, where the court said:

> * * * no sound reason can be advanced why revenue laws fixing the penalty and *interest* for delinquent taxes should not be given full effect in the case of taxes legally levied and assessed prior to the adjudication. * * * Whatever would be owing by the bankrupt at the time the payment is made if no bankruptcy had intervened, that the court should require the trustee to pay. It includes the original tax and all other sums accrued thereon

> under the revenue laws of the state up to the time the payment is actually made or tendered.

To the same effect is the case of *In re Scheidt Bros.* 177 Fed. 599, where the court held that under the Ohio statutes a penalty takes the place of interest and allowed 15 per centum penalty. The statute involved in the *Scheidt case* provided for a 10 per centum penalty on delinquent taxes, and, if it becomes necessary to collect the tax by distraint or court proceedings, a further penalty of 5 per centum. *Bridge Co.* v. *Mayer*, 31 Ohio State, 317. In the *Scheidt case* the court said that the allowance of a penalty is intended to cover and is treated as interest and collectible as a part of the tax.

The court below cites one case contra, the case of *In re Ashland Emery & Corundum Company*, 229 Fed. 829. This case holds that in the case of the State tax there under consideration, interest at the rate of 1 per centum per month is a penalty, and allows only 6 per centum per year interest.

The Government contends that this case is not applicable, first, because it refers to a State statute, and, second, because the tax in that case did not become due until after the adjudication in bankruptcy, the court laying special emphasis on that fact, whereas in the present case the tax accrued and by Section 14 (a) the Government's right to interest became fixed before the intervention of bankruptcy.

Nor is the case of *New York* v. *Jersawit*, 263 U. S. 493, decisive of the question presented in the case at bar. That case involved the construction of a statute of the State of New York which provided for payment on delinquent taxes of "10 per cent of such amount, plus 1 per cent for each month the tax remains unpaid." This language is distinctly different from that of the Federal Statute here considered. The wording of the New York Statute not only does not designate the 1 per cent as *interest*, but it would be difficult to construe it as interest. The decision that the 1 per cent "is added by the statute to the ten to make a single sum" is not only compelled by the peculiar wording of the statute but is in accord with the rule respecting interest on state taxes, laid down by the New York courts. In *City of Rochester* v. *Bloss*, 185 N. Y. 42, the Court of Appeals held that "Taxes, being mere statutory impositions, do not bear interest at common law. Nor do statutes providing for interest on debts, contracts, and judgments apply to taxes. Am. & Eng. Enc. of Law (2d Ed.) Vol. 27, p. 777. In Cooley on Taxation (3d Ed.) p. 19, referring to taxes, it is said, 'They do not draw interest, as do sums of money owing upon contract, but only when it is expressly given.'" The opposite rule prevails in the case of Federal taxes. In *Billings* v. *United States*, 232 U. S. 261, this Court holds that interest on Federal taxes is collectible at common law by way of damages, and in the absence of statutory provision therefor.

In re *Clark Realty Company*, 253 Fed. 938, involves neither a claim by the United States nor a State for taxes, but was a claim by the holder of tax sales certificates wherein the claimant was endeavoring to recover the rate of interest allowed by the laws of the State of Wisconsin for the redemption of property sold for taxes. The court held that the claimant was entitled to only 6 per centum per annum and based its decision upon the case of *Dayton, Trustee*, v. *Stanard, Treasurer of Pueblo County*, 241 U. S. 588.

Dayton, Trustee, etc., v. *Stanard, Treasurer of Pueblo County, Colorado*, 241 U. S. 588, did not involve a claim for taxes by the Federal Government or the State of Colorado. The controversy arose out of the sale for taxes of real property belonging to a bankrupt estate then in the course of administration in a court of bankruptcy. Because the property was in *custodia legis* at the time of sale, the court held the sales invalid and entered a decree cancelling the certificates of purchase. The Supreme Court held that the certificate holders were entitled to be reimbursed upon the cancellation of their certificates out of the general assets of the bankrupt estate and stated that, "while we are of opinion that the certificate holders were entitled to interest upon the amounts paid at the ordinary legal rate, applicable in the absence of an express contract, we think they are not entitled to the larger interest required to be paid on redemption from tax sales." This case therefore has no bearing upon the case at bar since the tax sales were void

and the purchasers were not entitled to the higher rate of interest allowable on the redemption of property sold for taxes.

The decision of the District Court for the Eastern District of Wisconsin in the *Matter of Winthers Motors Inc.* (decided August 27, 1924, unreported) is based upon the authority of the instant case and the *Jersawit case, supra*. The argument here made therefore applies with equal force to that case.

Since the United States is entitled to interest on delinquent taxes even in the absence of statute, it being allowed as damages for withholding payment of money due, *Billings* v. *United States, supra, a fortiore,* Congress may, by enactment, fix the rate of interest. Having expressly done so in Section 14(a) of the Revenue Act of 1916, the courts must give that rate effect.

II

Interest at the rate of 1 per centum per month provided by Congress is not excessive

The Government might well rest its case here were it not for the fact that the court below held interest at the rate of 1 per centum per month to be so excessive as to constitute a penalty notwithstanding the express contrary intention of Congress.

Interest at 1 per centum per month is not unusual nor is it considered excessive in commercial transactions. The legislatures of the several States have provided legal interest on simple contracts between individuals at rates ranging from 5 to 10 per centum

per year. On written contracts rates are provided at from 6 to 12 per centum, and higher in certain instances. In a majority of the Western States the legal rate of interest is 8 per centum and the maximum contract rate is 12 per centum. (Appendix.)

Under Section 63(a) of the Bankruptcy Act, the courts frequently allow claims against bankrupts on their written contracts carrying the maximum contract rates of interest, *In Re Hawks*, 204 Fed. 309 at p. 315, which in some instances may be higher than 12 per centum per annum. The duty of paying taxes is a high obligation of citizenship. For the courts to allow interest at the rate of 12 per centum on the claims of private creditors and not on claims for taxes due the Government is to subordinate a public duty to a private right. Certainly a discrimination so unjust and so contrary to public policy was never intended by Congress.

The Government is entitled to be made whole and recompensed both for the forbearance of the tax during the period of delinquency and the expense to which it is put as a result of such delinquency.

Failure to pay a tax when due automatically sets in motion various arms of the Government for the purpose of collecting the delinquent tax which would not otherwise be called into operation. This machinery is necessary for the proper support of the Government, and when set in motion for the collection of a particular delinquent tax the expense involved should be borne by the delinquent taxpayer.

In its endeavor to relieve other taxpayers of the burden of such increased cost of collection and to place it upon the delinquent taxpayer, where it properly belongs, Congress has provided a rate of interest calculated to reimburse the Government both for the forbearance and damages.

Therefore, unless the rate prescribed is beyond all reason, the intention of Congress should prevail.

The damage sustained by the Government in a particular case is extremely difficult, if not impossible, of determination. The cost of collection of delinquent taxes in the aggregate, however, is estimated with a greater degree of accuracy. Congress has provided a rate of interest to be paid on such delinquent taxes which approximately covers the expense to which the Government is put. The Commissioner of Internal Revenue reports that fully 1 per cent per month is required to meet this expense and compensation for forbearance of the tax during the period of delinquency.

In the absence of statute, interest is allowed as damages, and this court in the case of *Loudon* v. *Taxing District*, 104 U. S. 771, 774, stated that—

> All damages for delay in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

It is submitted therefore that in establishing a rate of interest at 1 per centum per month on delinquent

taxes Congress took into consideration not only the forbearance of the money during the period of delinquency but likewise the actual damages sustained by the Government due to the cost of collecting such taxes.

Congress having provided a rate of interest to be paid on delinquent Federal taxes and its intention being clear that the amount is to be paid as interest and not as a penalty, the rate named by Congress should be sustained.

III

The rate of interest provided by State law is not applicable to delinquent Federal taxes owing by bankrupts

While the lower court declined to allow the rate of interest provided in Section 14(a) of the Revenue Act, it did allow interest on the Government's claim for taxes at the rate prescribed in the general interest statute of the State of New York.

A general interest law of a state is not applicable under any circumstances even to state taxes, let alone Federal taxes. *People* v. *Central Pacific R. Co.*, 105 Cal. 576; *City of Rochester* v. *Bloss*, *supra*. To use such statute as the criterion by which to measure the interest to be allowed on Federal taxes is to apply the statute directly. It is well established this may not be done.

In *Boston & Maine R. Co.* v. *United States*, 265 Fed. 578; certiorari denied, 255 U. S. 577, it is said:

> Under the logic of the fundamental and salutory rule of uniformity unless a contrary

> intention clearly appears, statutes creating a system under which taxes are to be laid are generally, if not always, accepted as intending a system to work uniformly throughout the domain in which the law is to operate. *Hence it follows that the argument that the force of an express provision of a Federal statute should be controlled or abridged by a local state statute is wholly inadmissible.*

It is the duty of the courts to enforce the provisions of the federal internal-revenue laws relating to interest on delinquent taxes, and not to arbitrarily substitute a rate fixed by a state statute.

It is the province of the courts to enforce, not to make, laws; and if the law works inequitably the redress, if any, must be had from Congress, and arguments directed not to the construction of the act, but as to the justice of the method of distribution under the bankruptcy law, and the hardship resulting therefrom, can not influence judicial determination. *New Jersey* v. *Anderson*, 203 U. S. 483.

Application of the legal rates of interest provided by the laws of the various states to delinquent federal taxes necessarily would establish a shifting rate of interest thereon, depending upon the rate in force in the particular state. It is apparent, therefore, that a single uniform rate of interest to be paid on delinquent federal taxes is not only highly desirable, but essential to a proper and efficient determination of the Government's claims for taxes in bankruptcy proceedings.

CONCLUSION

Our argument, in brief, is this: It is claimed, first, that this 1 per cent a month is, both in name and fact, interest as defined and applied by this court in *Brown* v. *Hiatts*, 15 Wall. 177, and *Billings* v. *United States*, 232 U. S. 261, being nothing more than a commensurate compensation which Congress has undertaken to provide in a particular class of cases for the forbearance of money due from the taxpayer to the Government and for the increased cost of collecting the same. In the second place, it is insisted that since this per centum is merely interest, it is allowable either under Section 64(a) of the Bankruptcy Act as part of the tax itself, *In re Scheidt Bros.*, 177 Fed. 599, or under 57–j as interest *eo nomine*.

For these reasons the judgment of the Circuit Court of Appeals should be reversed.

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OCTOBER, 1924.

APPENDIX

Interest laws, 1923

States and Territories	Legal rate	Rate allowed by contract	States and Territories	Legal rate	Rate allowed by contract
	Per cent	*Per cent*		*Per cent*	*Per cent*
Alabama	8	8	Montana	8	10
Alaska	8	12	Nebraska	7	10
Arkansas	6–10	0–10	Nevada	7	7
Arizona	6	10	New Hampshire	6	[2] 6
California	7	12	New Jersey	6	6
Colorado	8	12	New Mexico	10	12
Connecticut	6	6	New York	6	[2] 6
Delaware	6	6	North Carolina	6	6
District of Columbia	6	8	North Dakota	6	10
Florida	8	10	Ohio	6	8
Georgia	7	8	Oklahoma	6	10
Hawaii	8	12	Oregon	6	10
Idaho	7	10	Pennsylvania	6	6
Illinois	5	7	Porto Rico	6	[4] 12
Indiana	6	8	Rhode Island	[3] 6	[1]
Iowa	6	8	South Carolina	7	8
Kansas	6	10	South Dakota	7	12
Kentucky	6	6	Tennessee	6	6
Louisiana	5	8	Texas	6	10
Maine	6	12	Utah	8	12
Maryland	6	6	Vermont	6	[5]
Massachusetts	6	[1]	Virginia	6	6
Michigan	5	7	Washington	6	12
Minnesota	6	10	West Virginia	6	6
Mississippi	6	8	Wisconsin	6	10
Missouri	6	8	Wyoming	8	12

[1] Any rate.
[2] Unless a different rate is expressly stipulated.
[3] New York has legalized any rate of interest on call loans of $5,000 or upward on collateral security.
[4] Pawnbrokers, 4 per cent per month.
[5] No statute.

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